

anywhere even where they have fiber-based collocations. The Commission should therefore reach a blanket conclusion of impairment for DS1s.

c. These Tests Address the Concerns of the D.C. Circuit

The fiber-based collocation test for DS3 transport answers the D.C. Circuit's concern that a route-by-route approach for transport could result in erroneous findings of impairment. The court objected to the possibility that if there were two identical routes A-B and A-C, and three CLECs had deployed transport on the first route but not the second route, the Commission would conclude that CLECs were impaired on the second route without taking into account the deployment on the first route. Although the court noted that the Commission "explain[ed] why competition on the A-B route should not be *sufficient* to establish competition is possible on the A-C route,"³⁹⁸ it believed that "this cannot explain the Commission's implicit decision to treat competition on one route as *irrelevant* to the existence of impairment on the other. Nor does the Commission explain whether, and why, the error costs (both false positives and false negatives) associated with a route-by-route market definition are likely to be lower than the error costs associated with alternative market definitions."³⁹⁹

These concerns do not arise if the Commission relies exclusively on the capacity thresholds. Those thresholds address potential deployment and do not rely on actual deployment at all. The court's concerns also are fully addressed by application of the *Triennial Review Order* triggers. As to that, it appears that the court's concern was based on a simple misunderstanding of the *Triennial Review Order* to which the Commission

³⁹⁸ *Id.* ¶ 401.

³⁹⁹ *USTA II*, 359 F.3d at 575.

could readily respond. The rules set forth in the *Triennial Review Order* permit the delisting of loops and transport where economic considerations, such as local engineering costs, topography, and customer density suggest that CLECs could deploy such facilities even though they have not yet done so.⁴⁰⁰ The Commission nowhere declared irrelevant to that potential deployment inquiry evidence that extensive deployment had occurred on a comparable route. To the contrary, presentation of such evidence is one way the ILECs could attempt to show non-impairment. Thus, if the Commission were to itself apply the potential deployment inquiry it previously delegated to the states, this would be a complete answer to the D.C. Circuit's concern.

The court's concerns are also addressed through application of the collocation triggers. As to the court's first concern – that the Commission had declared irrelevant deployment on the A-B route in assessing deployment on the A-C route, the Commission can explain that the fiber based collocater test will capture almost all such routes. If there are two routes with identical economic characteristics but deployment has only occurred on one route, it is almost certainly the case that there will be fiber-based collocators on the other route, resulting in a finding of non-impairment on that route. Outside of this limited context, the Commission can explain that the court's hypothetical of two routes, A-B and A-C, with identical economic characteristics but on which CLECs have deployed different levels of transport facilities is likely just that. In the real world, such examples are few and far between. If two routes have different levels of deployment in the real world, they likely have *different* economic characteristics, and when they have identical economic characteristics, the different deployment levels likely result from the

⁴⁰⁰ *Triennial Review Order* ¶ 410.

fact that the CLECs that deployed facilities on the first route subsequently determined that deployment had not been economic even on that route and so chose not to deploy facilities on the second route.

The fact is that it has now been eight years since passage of the Telecommunications Act. And during that time CLECs have extensively deployed high-capacity loops and transport facilities. It is on the basis of such deployment that the D.C. Circuit in *USTA I* suggested that the Commission should reconsider its impairment finding for transport, and on the basis of such deployment that the Commission found non-impairment for loops and transport facilities above the capacity thresholds. Clearly, CLECs have deployed loop and transport facilities where they believed it was feasible to do so. Indeed, as a result of the glut of production that characterized the telecommunications bubble that took place from 1998-2002, while there has been considerable deployment of loop and transport facilities in many locations that turned out *not to be economic*, there are very few locations in which deployment would have been economic but were missed. Where CLECs have not deployed loop and transport facilities, therefore, it is strong evidence that such deployment is not economically feasible. As this Commission explained, “actual marketplace evidence is the most persuasive and useful kind of evidence,” particularly with a market that is relatively “mature and stable,” and where there is no evidence that unbundling has deterred the construction of facilities, but where, to the contrary, construction has been quite robust.⁴⁰¹ That is presumably why SBC was the only ILEC that even attempted to make out a potential deployment case in the states, and its attempt suffered numerous flaws.

⁴⁰¹ *Id.* ¶¶ 93-95.

There may, of course, be some limited routes where deployment would be economic but has not yet occurred. But any of the alternatives proposed here will capture the vast majority of such routes. There are very few routes where deployment is possible and where CLECs have not yet collocated on each end of the route.⁴⁰² Accurately determining which routes/locations may yet support facilities construction by four or more CLECs would be extremely difficult. Any effort to make such a *determination risks an erroneous judgment of non-impairment on routes where the empirical evidence strongly suggests CLECs are impaired.* In contrast, an erroneous finding of impairment on a particular route would simply mean that the ILECs have to wait until deployment (or fiber-based collocation) actually occurs, which it certainly will if deployment is economic, before unbundling is eliminated on that route. Thus, the Commission should adopt the fiber-based collocation test as the best proxy for potential deployment on particular routes and should not extrapolate from empirical evidence to find potential deployment on routes where there are not even four fiber-based collocators.

As is already apparent from what we have said above, the fiber-based collocator test for transport, and retail/wholesale triggers for loops, applied on a route-by-route, or location-by-location basis, minimize error costs, which the D.C. Circuit held that the Commission should consider. The Commission can explain that evaluating impairment at the MSA level, or any similar broad geographical level, will inevitably produce far

⁴⁰² Moreover, on any such routes, it would take a very long time for the CLEC to establish transport, as it would have to both obtain the collocations and lay the fiber. This alone should render these routes irrelevant for purposes of the impairment inquiry. See Department of Justice and Federal Trade Commission Horizontal Merger Guidelines, § 3.2 (1992), *available at*: <<http://www.ftc.gov/bc/docs/horizmer.htm>> (DOJ will only consider within its analysis those entry alternatives that can be achieved with two years from initial planning to significant market impact).

greater risks of errors than a route-by-route analysis, as any such understanding will inevitably abstract away from concrete factors that prevent – or permit – deployment on particular routes. If, for example, an MSA-wide non-impairment determination were made in an MSA where CLECs had deployed multiple transport facilities on only 20% of the routes (and, where deployment was not possible on 80% of the routes), the Commission would make a non-impairment finding that would be inaccurate for the 80% of the routes.

A route-by-route (or location-by-location) determination carries no corresponding risks, and thus would minimize error costs. If deployment is economic on every route in a particular geographic area, such as an MSA, a route-by-route approach will lead to a finding of non-impairment throughout the MSA, just as would an MSA-by-MSA approach. But if deployment is economic on only a subset of the routes, such an approach will capture the variation.

The ILECs, however, want more than an opportunity to demonstrate non-impairment on every individual route. They previously argued based on the *Pricing Flexibility Order* that the FCC should draw inferences of potential deployment not just to other individual routes but to entire MSAs that might include routes with highly variable economic characteristics. Thus, although the ILECs pay lip service to the virtues of a granular approach to impairment, they in fact argue for a blunderbuss “no access anywhere” approach that would be just as unlawful as the “blanket” access rejected in *USTA I*. But as the D.C. Circuit explained, it was sensible for the Commission not to draw *dispositive* inferences regarding impairment on one route even from a route with

similar economic characteristics.⁴⁰³ And it is even more sensible not to draw dispositive inferences to entire MSAs (or any other large geographic area) – especially when the ILECs failed even to attempt to make such a showing in the state proceedings.

If the Commission were to find non-impairment through entire MSAs based on evidence stemming from a few routes in those MSAs, this would violate both *USTA I*'s granularity requirement and *USTA II*'s directive to consider the error costs of competing approaches. As this Commission previously concluded, the fact that deployment has occurred on some routes within an MSA does not demonstrate deployment is possible throughout the MSA. Because of the significant variation within MSAs, a finding of non-impairment for an entire MSA would not “track[] relevant market characteristics and capture[] significant variation.”⁴⁰⁴ Indeed, for similar reasons the Supreme Court rejected use of MSAs to define banking markets for assessing mergers, and they would be equally inappropriate to assess impairment.⁴⁰⁵ The Commission should therefore reiterate its finding of national impairment for loops and transport facilities below the capacity thresholds. And if it decides to go further, it should allow the ILECs to attempt to show non-impairment on particular routes and at particular locations using the triggers for loops and a fiber-based collocater test for transport.

3. The Commission Should Find That the Existence of Special Access Tariffed Services Should Play No Role in Its Unbundling Analysis

The D.C. Circuit has required the Commission on remand to “consider the availability of tariffed ILEC special access services when determining whether would-be

⁴⁰³ *USTA II*, 359 F.3d at 575.

⁴⁰⁴ *Id.* at 563.

⁴⁰⁵ *See United States v. Connecticut Nat'l Bank*, 418 U.S. at 670 (1963).

entrants are impaired,” while “taking into account such factors as administrability, risk of ILEC abuse, and the like.”⁴⁰⁶ While the court raised this issue in the context of CMRS services, it has obvious implications for the unbundling analysis appropriate to high-capacity loops and transmission facilities (and, indeed, for all other UNEs, since the ILECs will argue there is a tariffed service alternative for most UNE facilities). The Commission therefore properly seeks comment on how ILEC tariffed offerings fit into the Commission’s unbundling framework.⁴⁰⁷

As we show in what follows, the Commission should engage in the required analysis and conclude that the availability of special access services should not factor into impairment analysis. It should so conclude for multiple reasons: it would be contrary to the statute to do so; the price of special access is far in excess of the cost of providing the service, making it unsuitable for wholesale; it is not administratively feasible to address the extent to which the multiple tariffed rates and terms and conditions make special access services an economic alternative to UNEs; and the ILECs’ ability to change tariffed rates terms and conditions with virtually no notice and without any effective review would make reliance on tariffed services rife with the potential for abuse. Moreover, with respect specifically to the use of tariffed services as a substitute for high-capacity loops and transport UNEs, the evidence does not establish the absence of impairment and so eliminate the need for price-squeeze analysis. To contrary, the evidence establishes that competition will not survive if it is dependent upon inputs available only at high tariffed service rates.

⁴⁰⁶ *USTA II*, 359 F.3d at 577.

⁴⁰⁷ *NPRM* ¶ 9.

a. *The Statute Does Not Permit Consideration of Tariffed Services as Part of the Impairment Analysis*

In the *Triennial Review Order*, the Commission found that the Act forbids consideration of tariffed services as a substitute for UNEs since to do so would be to read out of the Act the requirement of cost-based pricing, and would improperly blur the distinctions Congress drew between services and facilities.⁴⁰⁸ The court of appeals rejected the first argument as circular and the second as unpersuasive.⁴⁰⁹ But in relying on these two invalid statutory arguments, the Commission failed to consider the most straightforward way in which the Act forbids the consideration of special access in impairment analysis.

The statutory impairment inquiry requires the Commission to consider the extent to which “the failure to provide access to . . . [ILEC] network elements would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer.”⁴¹⁰ A “network element” in turn is defined as “a facility or equipment used in the provision of a telecommunications service.”⁴¹¹ Put together, these provisions are susceptible of only one meaning: in addressing impairment, the Commission must consider the extent to which a competitor would be impaired if it were deprived access to the ILEC’s facilities or equipment. At the very least, that is by far the most reasonable construction of the statute.

⁴⁰⁸ *Triennial Review Order* ¶ 102.

⁴⁰⁹ *USTA II*, 359 F.3d at 576-77.

⁴¹⁰ 47 U.S.C. § 251(d)(2)(B).

⁴¹¹ *Id.* § 3(29).

The statutory test, therefore, requires analysis of how the competitor would fare if *deprived* of access to the incumbent's "facility or equipment" altogether. It is not possible to contort the grammar of the statute to find that the impairment inquiry permits the FCC to consider the extent to which competitors are impaired even when they are making use of ILEC facilities.

Not only is that construction of the statute compelled by its plain words, it is the one that makes the most sense. The evident purpose of the unbundling regulation, including the impairment requirement, is to require the ILECs to share their facilities when that is a prerequisite to the development of competitive markets (and not to impose that requirement when it is not). The most straightforward way to make that judgment is to consider whether competitors could compete without the benefit of ILEC facilities. That is plainly what Congress required the FCC to do. Not a whit of legislative history suggests that the unbundling regime was to function merely as a back-up to the extent that the access tariffs did not already provide whatever ILEC facilities were necessary. To the contrary, Congress evidently made the judgment that if competitors needed access to ILEC facilities, it was to be on the terms set out in the 1996 Act, and not on whatever terms the ILECs choose to offer in their tariffs. Moreover, all of the intractable difficulties that the court acknowledged can arise when one considers access services relating to administrability, price squeeze, and ILEC gamesmanship, are eliminated when the Commission relies on the plain meaning of the statutory text.

Because the Commission did not rely on this most straightforward reading of the statute in its decision to decline to consider tariffed services, the court had no occasion to review it. But if the Commission relies on the plain meaning of the statutory terms in this

manner, it will be providing the strongest possible defense of its decision. Any other result would be directly foreclosed by the statutory text.

b. The High Cost of Special Access

Even if the statute permitted consideration of special access, competitors' use of special access does not eliminate economic impairment because the price of special access greatly exceeds its cost. As a result, competitors who are forced to use special access as an input in their retail services are not able to compete in all markets in which the ILEC also competes. As the court explained, if wholesale rates are priced above cost, at some point "the 'impairment' threshold has been crossed," because the ILEC can set the wholesale input price so high that it prevents a competitor that must purchase that input from offering a competitively priced retail service. In other words, the ILEC wholesaler can engage in a classic "cost-price squeeze." Moreover, as the court also acknowledged, the ILEC has every incentive to engage in this anti-competitive behavior.⁴¹²

In fact, that is exactly what has occurred. The ILECs' market power over the market for DS1 and DS3 facilities, coupled with the Commission's decision largely to deregulate the pricing of those facilities, has resulted in prices that are far in excess of cost. The result is that special access has become the ILECs' most profitable line of business. Surely, Congress did not intend that the leasing of bottleneck facilities required by the incumbent LECs' competitors would be the incumbent LECs' most profitable business. Indeed, that is the very opposite of what it intended.

The Commission's current pricing rules enable the incumbent LECs to charge

⁴¹² *USTA II*, 359 F.3d at 576.

rates for special access that far exceed competitive levels, and their reported rates of return on interstate special access reflect that fact.⁴¹³ The Commission's pricing flexibility rules enable incumbent LECs to escape price cap regulation in many geographic areas, even though special access customers' ability to switch suppliers in those areas is limited. Even where services are still under price caps, the price cap formula does not require rates to decrease as costs decrease. Furthermore, the fact that the incumbent LECs' rate structures are divorced from economic costs⁴¹⁴ also contributes to excessive rates, particularly on thin routes.

Adopted in 1999, the Commission's pricing flexibility rules allow price cap LECs, such as the BOCs, to seek relief from regulation of their special access offerings, on an MSA-by-MSA basis, provided a certain level of competitive collocation exists within a given MSA.⁴¹⁵ The rules provide for two types of relief. Phase I relief allows

⁴¹³ Competition in Access Markets: Reality or Illusion, A Proposal for Regulating Uncertain Markets at v (ETI Aug. 2004) ("ETI White Paper"), attached to *Ex Parte* Letter from Colleen Boothby, counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, FCC, WC Docket No. 04-313 (Sept. 30, 2004) (noting that the profitability of the BOCs' access services "far exceeds 'competitive' levels"); *see also id.* at 7-9, 27-28, and 36-37 (explaining that competition is not constraining the BOCs' special access rates).

⁴¹⁴ *See* George S. Ford and Lawrence J. Spiwak, "Set It and Forget It? Market Power and the Consequences of Premature Deregulation in Telecommunications Markets," Phoenix Center Policy Paper No. 18, at 26 (July 2003) ("Ford & Spiwak"), *available at*: <<http://www.phoenix-center.org/pcpp/PCPP18.pdf>> (estimating that the price for special access service is "about three times its incremental cost").

⁴¹⁵ *See generally Pricing Flexibility Order.* The existence of competitive collocation within an MSA "is not necessarily related in a meaningful way to the extent of competition" within that MSA. *See, e.g.,* Ford and Spiwak at 13 (explaining that "MSAs are rather large geographic areas that extend well beyond the core population and business density of the cities contained therein," and that the presence of at least one collocater in a certain number of central offices within an MSA does not necessarily reflect a reduction in the incumbent LEC's market power within the MSA).

incumbent LECs that meet certain threshold requirements to provide volume and term discounts or enter into contract tariffs.⁴¹⁶ If the incumbent LECs can meet a slightly higher threshold, they can obtain Phase II pricing flexibility and escape price cap regulation altogether for certain services.⁴¹⁷ To date, the BOCs have been granted pricing flexibility in over 200 MSAs,⁴¹⁸ and the vast majority of special access services are provided in markets where the BOCs have pricing flexibility.⁴¹⁹

In certain areas where the BOCs have not been granted full pricing flexibility, some services remain under price caps. Historically, price cap indices for services under price caps have declined every year because of the operation of the “X factor” – a productivity offset that is part of the price cap formula – which was designed to produce decreases in prices (or at least a reduction in the upward adjustment for inflation) to reflect expected gains in productivity.⁴²⁰ Under the CALLS plan, however, the X factor has been set equal to inflation, so that nominal prices remain stable and real prices have fallen by only a very small amount, because of the low rate of overall inflation. The modest reductions in real prices have not kept pace with the very steep decline in costs in the telecommunications industry as a whole. The CALLS plan is set to expire on June 30, 2005, but the practice of setting the productivity factor equal to inflation will remain

⁴¹⁶ See 47 C.F.R. § 69.727(a).

⁴¹⁷ See *id.* § 69.727(b).

⁴¹⁸ See, e.g., *BellSouth Tariff F.C.C. No. 1*, § 23.2; *Pacific Bell Tariff F.C.C. No. 1*, § 31; *Qwest Tariff F.C.C. No. 1*, § 23; *Southern New England Telephone Company Tariff F.C.C. No. 39*, § 24; *Southwestern Bell Telephone Company Tariff F.C.C. No. 73*, § 39; *Verizon Tariff F.C.C. No. 1*, § 14; *Verizon Tariff F.C.C. No. 11*, § 15.

⁴¹⁹ ETI White Paper at v.

⁴²⁰ See *LEC Price Cap Order*, 5 FCC Rcd 6786 (1990).

in place until replaced by new FCC rules. Thus, FCC action is necessary to end the current situation in which prices fail to decrease even as costs continue to decline.

The incumbent LECs' rate structures permitted by this regulation in no way reflect underlying costs. The incumbent LECs' transport rate structures are highly distance-sensitive, despite the fact that once a network is built, the costs of providing service are largely distance-insensitive.⁴²¹ The result is that the differential between special access prices and the incumbent LECs' cost is greatest on longer intraLATA routes,⁴²² for which there tends to be little or no competition.

The Commission granted incumbent LECs Phase II pricing flexibility in the belief that if the Phase I and II "triggers" were met, "competition for a particular service within the MSA [would be] sufficient to preclude the incumbent from exploiting any individual market power over a sustained period."⁴²³ In reality, however, incumbent LECs have continued to exploit their market power in MSAs where they have been granted pricing flexibility.⁴²⁴ As the chart below describes, BOC interstate special access revenues

⁴²¹ For example, interexchange carriers in an intensely competitive marketplace long ago removed all distance-sensitive components from their rates for interstate toll calls. Notably, the ILECs' cost-based UNE rates are far less distance-sensitive than their special access rates. For example, evidence from the *Triennial Review* proceeding showed that the average per-mile charge for DS1 special access transport was \$13.72, while the corresponding UNE charge was only \$1.52. See *Ex Parte* Letter from Ruth Milkman, counsel for MCI, to Marlene H. Dortch, FCC, CC Docket No. 01-338 (Oct. 30, 2002).

⁴²² See, e.g., *id.* (providing information on special access and UNE rates for 5-, 10- and 20-mile circuits, and showing larger disparities between UNE and special access rates for longer mileage circuits).

⁴²³ *Pricing Flexibility Order* ¶ 25.

⁴²⁴ See, e.g., ETI White Paper at v, 36-37 (explaining that special access rates have not decreased in pricing flexibility markets, and that special access rates in pricing flexibility markets are higher than in markets where the BOCs have not been granted

nearly quadrupled between 1996 and 2003, rising from approximately \$3.4 billion to approximately \$13.4 billion. During the same period, the BOCs as a group enjoyed an almost six-fold increase in the rate of return for interstate special access (from 7.6 % to 43.7 %), with three BOCs reaping returns in excess of 60% in 2003.⁴²⁵ Special access rates have risen or stayed the same in virtually every MSA in which the BOCs have obtained Phase II pricing flexibility.⁴²⁶ According to one empirical analysis, the BOCs

pricing flexibility). *See also* Ford and Spiwak at 23 (“[de]regulated tariffed prices for special access services are nearly ubiquitously higher than regulated prices”). It is not surprising that the incumbent LECs have been able to exercise market power even in areas where they have been granted pricing flexibility. The FCC’s pricing flexibility analysis focuses on the potential for competition within a particular MSA. However, as we have just described, the relevant geographic market for channel mileage (transport) and channel terminations (loops) is the particular route or customer location being served. *Triennial Review Order* ¶¶ 401, 314, 332 (examining impairment on a route-by-route basis for transport and on a customer location basis for loops). The FCC’s MSA-wide approach thus leads to incumbent LECs gaining pricing flexibility for many routes and customer locations where they are still insulated from competition. *See* Ford and Spiwak at 23 (the BOCs’ ability to exercise market power in pricing flexibility markets may be caused by: (1) FCC triggers that are inadequate indicators of competition; (2) market boundaries that are too wide; (3) sunk costs of entry that prohibit a response to higher prices in non-competitive segments of the deregulated market; or (4) some combination of these factors). The BOCs have been able to exploit the flaws in the FCC’s pricing flexibility analysis and raise prices to supra-competitive rates in areas where they have been granted pricing flexibility.

⁴²⁵ *See also* ETI White Paper at 28 (showing that BellSouth, Qwest and SBC’s rates of return for special access services exceeded 60% in 2003, and earnings for all four BOCs “averaged a jaw-dropping 43.7%”).

⁴²⁶ *See, e.g., AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM No. 10593, AT&T Corp. Petition for Rulemaking, at 11-12 (Oct. 15, 2002) (“AT&T Petition”); *id.*, Reply Declaration of Lee L. Selwyn ¶¶ 4-15 (Jan. 23, 2003), attached as Exhibit 2 to Reply Comments of AT&T Corp. (Jan. 23, 2003); *see also* Reply Comments of Nextel Communications, Inc., RM No. 10593, at 4 (Jan. 23, 2003) (stating that it has experienced “significantly increased special access rates in every MSA subject to pricing flexibility, without exception, including MSAs the BOCs claim are served by multiple competitive providers,” and that SBC has raised special access rates as much as 25% in MSAs approved for pricing flexibility); Cable & Wireless Comments, RM No. 10593, at 6, 15-16 (“Whereas rates have been trending down as a result of ‘X-factor’ productivity

have charged an average of 13-14% more for interstate special access in areas where they have been granted pricing flexibility than in areas not subject to pricing flexibility, with deregulated prices nearly 30% higher than regulated prices for comparable services in some areas.⁴²⁷ The same analysis shows that the BOCs are pricing special access services at nearly three times their incremental costs, and the margin is even higher in deregulated areas than in regulated areas.⁴²⁸

Key Facts Regarding BOC Interstate Special Access

	1996	1997	1998	1999	2000	2001	2002	2003
BOC Special Access Revenues (\$ billions) ⁴²⁹	\$3.4	\$4.3	\$5.5	\$7.1	\$9.6	\$12.0	\$12.9	\$13.4
BOC Rate of Return ⁴³⁰								
BellSouth	16.17%	17.43%	31.29%	32.39%	36.68%	49.26%	56.54%	69.14%
Qwest	5.35%	13.59%	27.24%	32.18%	38.37%	46.48%	59.49%	68.08%
SBC	12.63%	16.01%	24.50%	39.55%	43.25%	54.60%	53.11%	63.16%
Verizon	2.14%	2.10%	8.53%	10.02%	15.63%	21.72%	23.81%	23.02%
All BOCs	7.55%	9.66%	17.92%	22.65%	28.41%	37.36%	39.78%	43.69%

At the same time that special access rates have been flat or rising, competition and technological advances have caused the rates for various other telecommunications

reductions . . . , the BOCs have used pricing flexibility only to raise rates.”); WorldCom Comments, RM No. 10593, at 1 (“Special access rates are now higher for virtually every rate element in pricing flexibility areas than in non-pricing flexibility areas.”); Ford & Spiwak at 23 (“Deregulated tariffed prices for special access services are nearly ubiquitously higher than regulated prices.”).

⁴²⁷ Ford & Spiwak at 25; *see also id.* at 34, Table 1 (showing average price increases for certain BOCs as high as 29% for DS0-digital special access (Verizon), 20% for DS1 special access (Qwest), and 12% for DS3 special access (BellSouth)); *see also* SPARC *ex parte*, RM-10593, Att. at 5 (Oct. 1, 2003) (showing price increases as high as 29.3% for DS1 (Verizon North), and 31.5% for DS3 (Verizon South)).

⁴²⁸ Ford and Spiwak at 26.

⁴²⁹ Data for 1996-2001 is from AT&T Petition, Friedlander Decl., Exhibit 2 (citing ARMIS 43-01, Row 1090, Column (s)). Data for 2002-2003 is based on the Friedlander methodology. *See also* ETI White Paper at 28, Figure 3.1.

⁴³⁰ Data for 1996-2001 is from AT&T Petition, Friedlander Declaration, Exhibit 1 (citing ARMIS 43-01, Table 1, Cost and Revenue Table, Special Access, Column (s): Average Net Investment, Row 1910 & Net Return, Row 1915). Data for 2002-2003 is based on the Friedlander methodology.

services to fall dramatically.⁴³¹ For instance, the Consumer Price Index for interstate toll service has fallen every year since 1996, with an average yearly decline of 6.0%.⁴³² Average revenues per minute for interstate toll service calls also have declined significantly, from \$0.12 in 1996 to \$0.07 in 2002.⁴³³ Average revenues per minute for international calls declined over 60% over the same period, falling from \$0.74 in 1996 to \$0.26 in 2002.⁴³⁴ Similarly, broadband prices have fallen in recent years, both in the U.S. and abroad.⁴³⁵

⁴³¹ See John Hodulik, "Daily Rap: The Special Access Debate," *Telco Wake-up Call*, (UBS Investment Research, Aug. 27, 2004) (noting that pricing for DS1 access had remained relatively stable "at a time when prices for most telecom services continue to plunge"); see also ETI White Paper at 12 (stating that although intense competition for interexchange switched voice and dedicated voice and data services has resulted in significant reductions in the prices of these services, this has not been the case for last mile special access services).

⁴³² See Paul R. Zimmerman, "Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service," Industry Analysis & Technology Division, FCC Wireline Competition Bureau, Table 3.1 (2003) (showing inflation-adjusted year-to-year percent change in CPI for interstate toll service of -5.9% for 1997, -2.4% for 1998, -3.9% for 1999, -12.2% for 2000, -3.3% for 2001, and -8.2% for 2002). The CPI for local services, by comparison, increased over the same six-year period, while the CPI for cellular telephone service declined by over 7% per year, on average, from 1999 to 2002. *Id.*

⁴³³ See Jim Lande and Kenneth Lynch, "Telecommunications Industry Revenues 2002," Industry & Technology Division, Wireline Competition Bureau, Table 9 (March 2004).

⁴³⁴ See Linda Blake and Jim Lande, "Trends in the International Telecommunications Industry," International Bureau, Tables 18 and 29 (July 2004) ("*Trends in the International Telecommunications Industry*").

⁴³⁵ See "Worldwide Broadband Prices Falling According to Point Topic Research," *Telecomworldwire* (Oct. 21, 2003) (stating that there was an average 25% decline in DSL broadband prices between September 2002 and September 2003, including cuts of 40% or more by Verizon and SBC); "Deutsche Telekom to Lower its Network Access Tariffs," *Telecomworldwire* (March 4, 2004); "BT to Reduce its Wholesale Broadband Prices," *Telecomworldwire* (May 13, 2004); "Telnor Mobil reduces prices" *Telecomworldwire* (Feb. 5, 2003); "TeliaSonera's Swedish Subsidiary Lowers its Fixed Line Telephony Rates," *Telecomworldwire* (Jan. 8, 2004).

Prices for telecommunications equipment used in the provision of special access services, such as fiber⁴³⁶ and cross-connects⁴³⁷ have also fallen significantly. Investment costs per circuit for trans-Atlantic submarine cables have declined from \$12,500 in 1996 to \$326 in 2003.⁴³⁸ As far back as 2000, industry reports were touting the fact that “[r]ecent advances in telecommunication and networking technology have dramatically lowered the unit cost of bandwidth.”⁴³⁹

In sum, the price of special access is greatly in excess of the cost of providing the

⁴³⁶ See “Fiber’s First Foray Finally,” *Telephony* (June 21, 2004) (“the costs of rolling out the [fiber] network have come down steadily”); “Broadcasting, Movies, FTTx, Data Dictate OFC 2004 Buzz,” *Fiber Optics Forecast* (March 3, 2004) (discussing how SBC is taking advantage of “much-lowered fiber costs”); “Chicago-Area Cable TV Supplier’s Talks Aim For Bankruptcy Protection,” *Chicago Tribune* (explaining that companies laid “many thousands of miles of fiber-optic cable during the late 1990s anticipating a vast leap in demand for bandwidth,” leading to overcapacity and price wars); “Capacity Glut May Be Ending, Says CEO of Fiber-Optic Network Company Level 3,” *Omaha World-Herald* (May 19, 2004) (discussing the “glut of fiber-optic capacity that has held down prices and plagued network operators”); “Tulsa, Okla.-Based AFN Communications is Bought by West Virginia Company,” *Tulsa World* (Feb. 28, 2004) (describing the effects of a “fiber-optic bandwidth glut and plunging prices” for fiber-optics); “Satellite” (Feb. 24, 2004) (noting that fiber is very cost effective due to the fact that there is so much unlit fiber already in the ground); see also “New Cable Installing Method Wins Converts at Omaha, Neb., University Campus,” *Omaha World-Herald* (June 9, 2004) (describing an installation method that greatly reduces the cost of upgrading fiber).

⁴³⁷ See, e.g., “Alcatel Unveils All-Optical Cross-Connect,” available at: <www.lightreading.com/document.asp?doc_id=1302&site=lightreading> (July 31, 2000) (claiming that Alcatel’s CrossLight photonic cross-connect reduces carrier network costs by 40 percent); Eastern Research – Utilities, available at: <http://www.erinc.com/apps_wireline/utilities.htm> (touting cost savings to be gained by deploying a DNX Access Concentration Solution that combines the functionality of a DACS and multiple channel service units (“CSUs”) and multiplexers); “Advancing Optical Technologies in Spite of the Telecom Slowdown!,” available at: <<http://www.comsoc.org/livepubs/ci1/Public/2002/Nov/gstedlin.html>> (“network bandwidth is getting cheaper and abundant”).

⁴³⁸ *Trends in the International Telecommunications Industry*, at 6 (Figure 9); see also *id.* at Table 5.

⁴³⁹ Zenon D. Carlos, “A Simplified Overview of Undersea Cable Development – The Eruption of Bandwidth Across the Pacific,” *PTR*, Vol. 22, Number 1, at 35 (3rd quarter 2000).

service; so much so that in many markets and along many routes it is simply not economic to use it as a wholesale input.

c. It is Not Administratively Feasible to Consider Tariffed Services

In rejecting the Commission's proffered reasons for declining to consider tariffed services, the court acknowledged that "a rule that allowed ILECs to avoid unbundling requirements simply by offering a function at lower-than-TELRIC rates might raise real administrab[ility] issues" that might "support a blanket rule treating the availability of ILEC tariffed service as irrelevant to impairment."⁴⁴⁰ Thus the court made clear that the Commission might "explicate these complications," and "defend[] its decision in those terms."⁴⁴¹ The Commission should do just that.

The Commission has had a difficult time conducting price-squeeze analysis when required to do so in evaluating a rate. When MCI provided a cost-squeeze analysis of one UNE-P rate in Massachusetts in conjunction with its argument that Verizon had not satisfied the public interest requirement for interLATA entry pursuant to 47 U.S.C. § 271(d)(3)(C), the Commission was unable to respond that argument in a rational way in the 90-day review period set out in the statute. The result was a decision by the D.C. Circuit reversing and remanding the Commission's price-squeeze analysis.⁴⁴² It ultimately took the Commission two years to draft a response that responded to the remand.⁴⁴³

⁴⁴⁰ *USTA II*, 359 F.3d at 576.

⁴⁴¹ *Id.*

⁴⁴² *WorldCom, Inc. v. FCC*, 308 F.3d 1 (D.C. Cir. 2002).

⁴⁴³ *Application of Verizon New England Inc., Bell Atlantic Communications, Inc.*

But as difficult and time consuming is a price-squeeze analysis on even a single rate, what would be required here is infinitely more complex. Price-squeeze analysis requires a comparison between a retail rate and a competitor's costs that include (but are not limited to) the rate for the particular wholesale input that is being challenged. Here, even if one considers only the use of special access as a substitute for high-capacity loop and transmission facilities, there are thousands upon thousands of rates that would have to be compared with each other.

On one side of the ledger would be every retail rate in every jurisdiction for every service that makes use of high-capacity transmission or loop facilities. Those would include, *inter alia*, enterprise telephone exchange services, access services of every kind for enterprise and mass market customers, and the entire range of data services and telecommunications services used by information service providers. And most of those rates vary in multiple pricing zones in all 50 states and, as the incumbent LECs gain pricing flexibility in a variety of retail markets, may vary from customer to customer as well.

In addition to the complexity of retail rate structures, special access prices are also complex, making it difficult to derive the wholesale rates to which the retail rates must then be compared. The result of pricing flexibility is a multiplicity of rates and other highly relevant terms and conditions that vary not only from incumbent LEC to incumbent LEC, from state to state, and from special access pricing zone to special access pricing zone, but from MSA to MSA as well. Special access pricing zones and

(d/b/a Verizon Long Distance), Nynex Long Distance Company (d/b/a Verizon Enterprise Solutions) and Verizon Global Networks Inc., for Authorization To Provide In-Region, InterLATA Services in Massachusetts, 19 FCC Rcd 2839 (2004).

MSAs bear little relation to the retail rate zones that constituted the geographic limits of the retail rates. Just lining up the zones to make geographically appropriate comparisons would be extraordinarily challenging.

But that only scratches the surface of the difficulties in administering a regime which attempted to consider special access pricing as a variable in a price-squeeze analysis. Special access pricing is notoriously distance sensitive, in ways that frequently bear no relation to retail pricing. Price-squeeze analysis would have to be separately performed based on the mileage of the particular special access circuit needed to serve a customer, which could vary from CLEC to CLEC, depending on the location of the CLEC's switch or other network facilities. Special access pricing is also notoriously subject to term and volume discounts, as well as other use commitments. Here too the Commission would be called upon to make defensible assumptions about the term commitment assumed in the analysis, which would in turn require the Commission to evaluate the nature of the CLEC making use of the service being evaluated. Or, more likely, the Commission would have to analyze multiple scenarios based on different term assumptions. It is far from clear how the Commission would take into account volume commitments – perhaps it would have no choice but to consider the particular circumstance of “the telecommunications carrier seeking access” as well as the particular “services it seeks to offer” to every particular customer.⁴⁴⁴

Consequently, thousands upon thousands of price-squeeze scenarios would have to be considered by the Commission, and any more generalized and administratively practical analysis would be fairly subject to legal challenge as arbitrary. For all of these

⁴⁴⁴ 47 U.S.C. § 251(d)(2)(B).

reasons, it would be impossible for the Commission to engage in the analysis that would be required before the Commission could conclude that special access keeps competitors from being impaired without access to high-capacity loops and transmission facilities for each of the services they seek to offer. The Commission could not undertake the necessary analysis even if it had all of the time and resources in the world. Just as the court suggested, consideration of special access would in this way make the unbundling process unadministerable.

d. The Risk of ILEC Abuse and the Different Market Opportunities Presented by Special Access and UNEs Also Should Lead the Commission to Refuse to Consider Tariffed Services as Part of the Impairment Analysis

Additionally, even if the Commission could perform all of the necessary price-squeeze analysis – which it cannot – and even if that analysis showed that in at least some situations there was no impairment – which it would not – it would all be for naught, for under pricing flexibility the ILECs now have the flexibility to change their special access rates almost at will. Thus, as the court acknowledged, even if these obstacles could be overcome, the Commission would have to take into account the “risk of ILEC abuse,”⁴⁴⁵ as an additional reason to decline to consider special access pricing in its impairment analysis.

For the unbundling regime to be administrable, and to meet the needs of the industry for some predicatability in business relationships, the interconnection agreements that set out the terms of unbundling typically stay in place at least for three

⁴⁴⁵ *USTA II*, 359 F.3d at 577.

year periods, and changes in the underlying unbundling law occur only periodically and then are subject to adjustment only pursuant to the agreements' change of law provisions.

But unlike other costs that factor into an impairment analysis, special access prices can change, and do change radically, as the ILEC sees fit. In the MSAs where the incumbent LECs have been granted Phase II pricing flexibility, special access prices are no longer subject to price cap regulation and the incumbent LECs have the ability to increase rates on one day's notice.⁴⁴⁶ And the incumbent LECs have, in fact, increased their rates in Phase II MSAs. In August, for example, Qwest increased its DS3 interoffice mileage rates by over 100 percent.⁴⁴⁷

That being so, "tariffed services present different opportunities and risks for the requesting carrier than the use of UNEs, or non-incumbent LEC alternatives."⁴⁴⁸ Moreover, as the D.C. Circuit also suggested, the ILECs have every incentive to strategically raise rates to create cost-price squeezes as they become aware of the opportunity to do so. Thus, even if the Commission completed a price-squeeze analysis and concluded that competitors are not impaired as a result of the availability of special access, the ILECs could (and would) promptly raise special access rates and promptly render the unbundling determination obsolete. Instead of a regime of three years of stability in UNE access, the result would be an unending game of cat and mouse, with ILECs raising rates, CLECs responding by demanding the initiation of a new UNE case, and the Commission caught in the middle trying to administer the unadministrable. For

⁴⁴⁶ 47 C.F.R. § 69.727(b).

⁴⁴⁷ Qwest Tariff FCC No. 1, Transmittal No. 206 (Aug. 16, 2004).

⁴⁴⁸ *USTA II*, 359 F.3d at 577 (quoting *Triennial Review Order* ¶ 102).

this reason as well, the Commission should decline to consider tariffed services as part of its impairment analysis.

e. The Empirical Evidence Does Not Justify Consideration of Tariffed Services as Part of the Commission's Impairment Analysis

The ILECs argue that there is empirical evidence that shows that competitors have been able to compete using ILEC special access services instead of UNEs. That argument fails, for two reasons.

First, the ILECs' evidence fails to capture the dynamics of the marketplace. Competitors' reliance on special access in the past proves little or nothing about whether special access today and in the future is an adequate substitute for UNEs. MCI has made extensive use of special access tariffs to purchase DS1-based services, notwithstanding the extraordinarily high prices the ILECs charge for such services.⁴⁴⁹ It has done so because it has little choice. DS1 is a classic bottleneck facility that is a critical input to a great many telephone services. For nine years the ILECs have campaigned to prevent competitors from purchasing DS1 facilities as unbundled network elements, despite the fact that throughout this period the Commission has consistently found that competitors are impaired without access to UNE DS1s.

The ILECs have used both legal and illegal means to grow their special access profit. For example, the ILECs have responded to MCI orders for UNEs by claiming they were not obligated to provision the element based on plainly unjustified "constructions" of their interconnection agreements or tariffs.⁴⁵⁰ Or they improperly

⁴⁴⁹ Mills Decl. ¶¶ 9-10.

⁴⁵⁰ *Id.* ¶ 12.

claimed that the request for unbundled network elements required them to create “new facilities” which they claimed they had no obligation to provide, a tactic the Commission in the *Triennial Review Order* made clear was improper.⁴⁵¹ Similarly, through naked pleading that they needed special access revenues to meet unspecified “revenue requirements,” until the *Triennial Review Order* the ILECs had persuaded the Commission to impose a series of otherwise unjustified use restrictions and “commingling” bans that, as the Commission has at last acknowledged, made it virtually impossible for MCI and others to make use of DS1 and DS3 UNEs.⁴⁵² Indeed, it is precisely because the Commission has finally acknowledged that these restrictions are unjustified (and the *USTA II* decision declared flatly illegal the last of the shifting justifications upon which the Commission has relied to support these restrictions⁴⁵³) that the ILECs now have come forward with the extraordinary claim that there is no impairment in the DS1 and DS3 high-capacity loop and transport marketplace.

But the fact that the ILECs have been successful at forcing competitors to rely on special access is not proof that those competitors as a result are not impaired without access to UNEs. Even the current level of competition is not sustainable as long as the incumbent LECs’ competitors are forced to rely on inputs that are priced far above the cost that the incumbent LECs incur in providing those inputs to themselves. That concern applies not only to the local exchange and exchange access markets, but to interLATA markets as well. The extensive use of BOC DS1 and DS3 services by

⁴⁵¹ *Triennial Review Order* ¶¶ 632-641; see Mills Decl. ¶ 13.

⁴⁵² *Triennial Review Order* ¶¶ 590, 596 & n.1830; see Mills Decl. ¶¶ 11, 13-14.

⁴⁵³ *USTA II*, 359 F.3d at 591-592.

competitive carriers as an input for their retail interLATA services developed during this period in which the court's line-of-business restriction protected interLATA competition. When the ILECs were barred from providing interLATA services, high-cost special access did not prevent competition from developing in markets in which the ILECs were not permitted to compete. Price squeeze is not a problem when the carrier that is in a position to squeeze out its competitors is prohibited from serving the market at all.

With the granting of the last section 271 application in 2003, however, the line-of-business restrictions are now gone. The Commission granted in-region authority precisely because it concluded that UNE-based competition permitted competitors to obtain needed facilities at cost-based rates, and so eliminated the risk of a price squeeze that had necessitated the line-of-business restrictions.

A snapshot of the way things were in 2003 does not help answer whether competitors will continue to be able to compete in the interLATA markets (or any other markets) using special access services now and in the future. Because that data is not determinative – and indeed is largely irrelevant – it does not disprove what common sense suggests, and what price-squeeze analysis would demonstrate: that competition based on the ILECs' DS1 and DS3 special access services is not sustainable.⁴⁵⁴

As a result, even though the use of high-cost special access circuits as a wholesale input is not sustainable in a world in which the ILECs are now competing in all markets, the marketplace effects of reliance on special access will not be captured in a snapshot of the market taken during the period when the interLATA restrictions were just being lifted. The impairment in the competitive marketplace instead will show itself more

⁴⁵⁴ Mills Decl. ¶¶ 22-23.